



External Audit Report

HVJ Associates, Inc.

TxDOT Compliance Division

Objective

To determine the impact of the franchise agreements with HVJ South Central Texas – M&J and HVJ North Texas – Chelliah Consultants, Inc. on doing business with TxDOT (e.g. administrative qualification).

Overall Conclusion

Franchise agreements with HVJ South Central Texas - M&J, Inc. and HVJ North Texas – Chelliah Consultants, Inc. do not prohibit HVJ Associates, Inc. or the franchisees from administrative qualification or doing business with TxDOT. However, HVJ Associates, Inc. can enhance its accounting procedures to ensure its overhead rate proposal is accurately reported and compliant with Federal Acquisition Regulations.

HVJ Associates Inc.'s Management's response and action plans are included in Appendix B beginning on page 7 of this report.

Project Information

This audit was conducted for the Professional Engineering Procurement Services Division (PEPS), TxDOT Administration and the Chief Audit and Compliance Officer. The audit was included in the fiscal year 2018 Compliance Division External Audit work plan and was performed by Shauntee' Dobbins (Engagement Lead) and Ruben Juarez. Engagement fieldwork was conducted from April 2018 through June 2018.

We conducted this audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions on our audit objectives.

Background

In 2016, HVJ Associates, Inc. area offices in Austin and Dallas, Texas transitioned into franchises of HVJ Enterprise, Inc., a subsidiary of HVJ Associates, Inc. (See Appendix A). The franchise agreement allows the franchises, HVJ South Central Texas – M&J, Inc. (HVJ SCTX) and HVJ North Texas – Chelliah Consultants, Inc. (HVJ NTX) to operate as separate legal entities and requires each franchise to pay royalty fees to HVJ Enterprise, Inc.

Under the new operating arrangement, HVJ Associates, Inc. and each franchise submitted a fiscal year 2016 overhead rate proposal to PEPS to become administratively qualified. As part of its review, PEPS identified significant adjustments in the proposed rates. The proposed rate for HVJ Associates, Inc. was reduced by 24.68%, from 172.63% to 147.95% due to the inclusion of unallowable and unsupported costs and franchise costs which did

not have prior PEPS or Compliance Division determination. The adjustments to the proposed rates indicated a risk HVJ Associates, Inc. was not using proper accounting methodology. Additionally, the franchise operating structure created a risk or the appearance that the franchises may not be operating independently, which could impact their Disadvantaged Business Enterprise status.

Scope

The scope of this engagement included current operations of HVJ Associates, Inc. and costs included in the administrative qualification proposal.

Methodology

The methodology used to complete this engagement included the following:

- Reviewing the franchise agreements and background information for HVJ Associates, Inc., HVJ SCTX and HVJ NTX to understand the organizational structures.
- Reviewing DBE qualification documentation provided by Texas Unified Certification Program (TUCP) members, City of Austin – Small and Minority Business Resources and North Central Texas Regional Certification Agency.
- Reviewing accounting software to evaluate its ability to properly segregate direct and indirect costs, allocate indirect costs and segregate the accounting records of HVJ Associates, Inc. and its related entities.
- Interviewing HVJ Associates, Inc.’s Executive Vice President, Vice President of Finance and Administration, Controller, and support staff to understand operations, franchise structure and accounting procedures.
- Reviewing labor charges to determine whether employee efforts overlapped between HVJ SCTX and HVJ NTX.
- Reviewing specific items of costs, such as accounting services, information systems, and human resources to ensure these costs are reported in accordance with Federal Acquisition Regulations.

Observations/Recommendations

Organization Structure

Although HVJ SCTX and HVJ NTX are owned and operated by former HVJ Associates, Inc. employees, we did not identify evidence they are commonly controlled, or dependent upon, HVJ Associates, Inc. According to AASHTO Uniform Audit and Accounting Guide (Guide), common control exists “...when business is conducted at less than arm’s length between businesses and/or persons that have a family or business relationship.” The Guide further describes common control as, “...when a related party has effective control over the operating and financial policies of the related entity.”

The review of the TUCP DBE qualification documentation identified HVJ Associates, Inc., HVJ SCTX, and HVJ NTX as separate legal entities with their own tax identification numbers. The documentation showed the franchises were started with originating funds from their owners/operators, who are responsible for day-to-day operating decisions and the profits and losses of the entities. There are no employees of HVJ Associates, Inc. on the boards of HVJ SCTX or HVJ NTX, mitigating the risk of HVJ Associates, Inc. exercising control over the operating and financial policies of the franchises.

Accounting Systems

HVJ Associates, Inc. maintains a separate accounting system from HVJ SCTX and HVJ NTX. Although the entities use the same accounting software, they maintain separate charts of accounts, which allows for segregation of financial records.

HVJ Associates, Inc. did not identify unallowable indirect costs at the transaction level. Instead, it relied on its auditors to identify unallowable items through sampling during the overhead rate audit. This process does not identify all unallowable costs attributed to a fiscal year and results in an inflated overhead rate proposal. When unallowable costs are not accurately removed from costs pools, TxDOT's PEPS Division may significantly adjust or deny proposals. This can extend the time required to become administratively qualified and result in a lower-than-anticipated rate.

Recommendation

HVJ Associates, Inc. should implement a process to identify unallowable costs at the transaction level to increase the accuracy of its overhead rate proposal. Accounting policies should be updated to include this practice and unallowable costs should be accounted for in specified accounts in the general ledger.

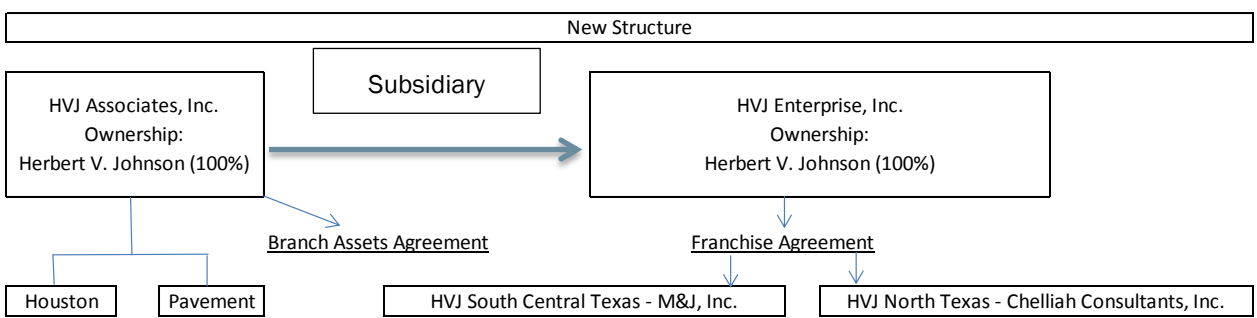
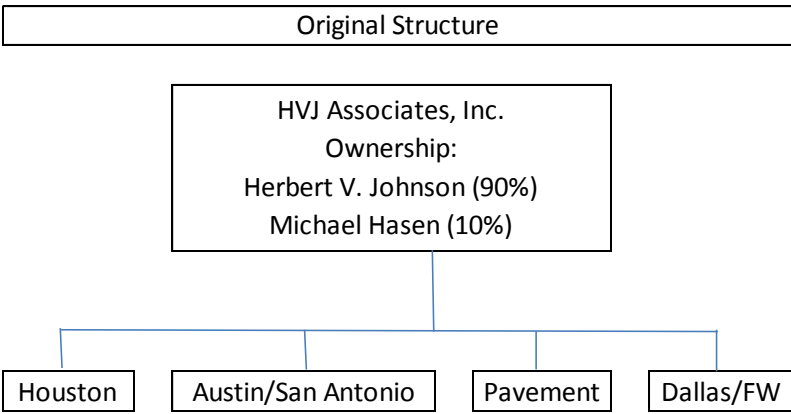
Selected Items of Cost

The franchise agreement between HVJ SCTX, HVJ NTX and HVJ Enterprise Inc. requires the franchises to pay a monthly "Contracted Service and Royalty Fee" to HVJ Enterprise, Inc. During the administrative qualification review, PEPS determined the total fee to be unallowable per FAR 31.205.20 and excluded it from the overhead rate calculation. However, the Contracted Services portion of this fee is used to cover costs related to general business overhead that HVJ Enterprise, Inc. provides to the franchisees. This includes items such as business development, accounting support, software, and human resources support. These costs are typically allowable overhead expenses. However, if Contracted Services and Royalty fees are not separately invoiced or documented in a transparent manner, PEPS is unable to review and evaluate them for allowability.

Recommendation

If overhead costs included in royalty fee payments are to be considered in franchisee overhead rate proposals, they must be invoiced and documented in a manner in which they can be readily identified.

Appendix A



Appendix B



Houston 6120 S. Dairy Ashford Rd.
Austin Houston, TX 77072-1010
Dallas 281.933.7388 Ph
San Antonio 281.933.7293 Fax
www.hvj.com

August 30, 2018

Attn: Patrick McKinney, CIA
Section Director, External Audit and Advisory Services
Texas Department of Transportation
Compliance Division

RE: External Audit Report

This letter is in response to your Recommendations for changes to HVJ Associates, Inc. Accounting Systems and Selected Items of Cost within the External Audit Report we received on August 18, 2018.

Accounting Systems

HVJ Associates, Inc. has recognized the need to adjust our accounting processes to identify unallowable costs at the transaction level.

We are currently implementing new General Ledger overhead accounts in our accounting system. The new accounts will allow for separation of allowable from unallowable expenses at the GL level. The new GL will be implemented at the beginning of the 2019 calendar year.

Process documentation which incorporates the identification of unallowable costs at the transaction level and the GL coding standards will also be completed by the end of 2018.

Training relative to the new GL codes and process began early in the calendar year of 2018 and will continue as each stage of the process change is completed.

Selected Items of Cost

HVJ Enterprise, Inc. modified the standard invoicing process and invoice templates in the calendar year of 2018. The new format and process clearly itemizes each component of the charges relative to the Contracted Service costs and are supported by formalized agreements with each Franchisee.

Please do not hesitate to contact me should I be of further assistance.

Sincerely,

A handwritten signature in blue ink that reads "Mary L. Grimes". The signature is fluid and cursive, with the first name "Mary" and last name "Grimes" clearly legible.

Mary Lou Grimes
Controller

CC: Namondo (Didi) Ndando, Vice President